private forecasters, as reported in the Blue Chip Indicators (we are a contributor to that monthly consensus forecast). If Congress chooses to accept this rosy scenario, it can avoid any disturbing battles over the deficit and how to cut spending or raise taxes. Obviously, the political climate over the next few months will determine what will be done.

The cynics are betting Congress will turn its head and focus on re-electing itself. Furthermore, many economists are chagrined by the expected willingness of Congress to ignore the disparities in these figures and go on with the business of getting elected. Nevertheless, economists also need to be reminded that they are the ones who helped create these numbers. When taxes, spending, politicians and economists meet, what occurs is not pure politics and not pure economics. Instead we have a unique alloy -- political economy -- which combines the best and worst of each craft. The next year should be interesting in seeing the forging of this alloy, especially during a changing economy.

A COMPARISON OF ECONOMIC FORECASTS

Economic Variable/Source	Percentage Growth by Calendar Year 1988	1989
Real GNP Growth Rate (4Q to 4Q)		
CBO	1.8	2.6
Administration*	2.4	3.5
Consensus**	1.8	2.1
GNP Deflator (4Q to 4Q)		
CBO	3.9	4.2
Administration	3.9	3.7
Consensus	3.8	4.3
CPI-U (4Q to 4Q)		
CBO	4.9	4.8
Administration	4.3	3.9
Consensus	4.2	4.8
Civilian Unemployment Rate (Cal. Avg.)		
CBO	6.2	6.1
Administration	5.8	5.5
Consensus	6.2	6.3
Three-Month Treasury Bill Rate (Cal. Avg.)		
CBO	6.2	6.7
Administration	5.3	5.2
Consensus	5.9	6.4
Ten-Year Government Bond (Cal. Avg.)		
CBO	9.3	9.5
Administration	8.0	7.4
Consensus	8.9	9.1

*Some of the Administrations economic assumptions are taken from estimates published by the Council of Economic Advisers in a press release dated December 23, 1987.

**Blue Chip Indicators, January 10, 1988.

FEDERAL DEFICIT PROJECTIONS

Source	Fiscal Years ($s in Billions) 1988	1989	1990
CBO	$157	$176	$167
Administration	$147	$130	$104
GRH Target (including margin)	$154	$146	$110

Sources: Statement of James L. Blum (Acting Director, CBO) before the Committee on the Budget, U.S. Senate, February 4, 1988; "Reagan Plan for '89 Is Less Confrontational, Seeks Spending Rise for Spaces, Aids Research," The Wall Street Journal, February 19, 1988, page 12; and Rose Gutfeld, "Budget Assumes a Continued Expansion of Economy, Despite Risky Environment," The Wall Street Journal, February 19, 1988, page 12.

U.S. ECONOMIC OUTLOOK

	QUARTERS								YEARS			
	Actual		Forecast						Actual		Forecast	
	1987.3	1987.4	1988.1	1988.2	1988.3	1988.4	1989.1	1989.2	1986	1987	1988	1989
AGGREGATE ECONOMY												
Gross National Product (billions of dollars)	4524	4598	4642	4698	4774	4847	4933	5020	4235	4486	4741	5060
% Change	7.3	6.7	3.9	4.9	6.6	6.2	7.3	7.2	5.6	5.9	5.7	6.7
% Change (w/out inflation)	4.3	4.2	0.8	1.6	3.3	2.7	2.9	3.1	2.9	2.9	2.5	2.8
Consumer Price Inflation (CPI)	3.9	3.6	3.5	3.9	4.4	4.6	4.7	4.6	1.9	3.7	3.9	4.6
GNP Inflation (GNP Deflator)	2.8	2.7	3.0	3.2	3.2	3.5	4.2	4.0	2.6	3.0	3.0	3.9
Unemployment Rate - Civilian	6.0	5.9	5.9	6.0	6.0	6.0	5.9	5.9	7.0	6.2	6.0	5.8
Civilian Employment-Household Basis (millions)	112.9	113.5	113.9	114.3	114.7	115.1	115.7	116.2	109.6	112.4	114.5	116.4
Percent change	2.5	2.3	1.6	1.1	1.5	1.6	1.8	1.8	2.3	2.6	1.8	1.6
Index of Industrial Production	130.9	133.0	132.9	133.1	134.6	135.7	137.0	138.4	125.1	129.8	134.1	138.7
Manufacturing Capacity Utilization	81.4	82.2	82.1	82.2	82.6	82.7	82.8	83.0	79.7	81.0	82.4	82.8
Domestic Auto Sales	8.0	6.7	6.9	6.7	7.1	6.3	6.9	6.8	8.2	7.1	6.8	6.9
Federal Tax Receipts (NIPA) as % of GNP	20.4	20.4	20.1	20.2	20.1	20.3	20.6	20.6	19.5	20.4	20.2	20.6
Federal Expenditures (NIPA) as % of GNP	23.4	24.0	23.9	23.7	23.6	23.6	23.4	23.3	24.4	23.8	23.7	23.3
Deficit(NIPA)	-135.8	-165.9	-175.0	-164.5	-165.0	-161.2	-137.7	-133.2	-204.7	-152.8	-166.4	-134.7
as % of GNP	-3.0	-3.6	-3.8	-3.5	-3.5	-3.3	-2.8	-2.7	-4.8	-3.4	-3.5	-2.7
REAL ESTATE MARKETS												
HOME SALES												
Total Single-family Home Sales (thousands, single-family resales plus 97 percent of single-family starts)	4550	4467	4210	4280	4312	4389	4378	4425	4717	4649	4297	4441
Percent change -- year ago	-3.2	-10.9	-12.9	18.5	5.2	-1.7	4.0	1.1	10.9	-1.4	-7.6	3.3
Existing Single-family Home Sales (thousands)	3430	3420	3178	3204	3260	3325	3327	3365	3565	3526	3242	3392
Percent change -- year ago	-4.4	-12.1	-12.1	-11.2	-5.0	-2.8	4.7	1.1	10.9	-1.1	-8.1	4.6
Housing Starts (thousands)	1623	1517	1432	1494	1501	1551	1551	1556	1805	1621	1494	1552
Percent change -- year ago	-7.7	-10.9	-20.2	-7.3	-7.5	2.3	8.3	4.2	3.6	-10.2	-7.8	3.9
Single-Family Units	1155	1079	1064	1109	1085	1097	1084	1092	1179	1147	1088	1082
Percent change -- year ago	0.4	-6.8	-15.3	-2.9	-6.1	1.6	1.9	-1.5	10.0	-2.8	-5.1	-0.6
Multi-Family Units	468	437	369	385	416	454	468	463	631	478	406	470
2-4 Family Units	56	55	46	48	52	57	59	58	84	65	51	59
Percent change -- year ago	-27.0	-37.5	-42.1	-33.7	-6.6	3.9	26.9	20.4	-10.1	-22.3	-21.7	15.7
5+ Family Units	412	382	322	336	364	397	409	405	542	409	355	411
Percent change -- year ago	-22.6	-16.1	-29.8	-15.2	-11.7	3.8	26.9	20.4	-5.9	-24.6	-13.2	15.8
New Single-family Home Sales (thousands)	663	635	627	643	659	692	664	697	750	674	655	687
Percent change -- year ago	-3.4	-10.7	-13.3	-4.6	-0.6	9.0	5.9	8.4	9.0	-10.1	-2.8	4.9
Mobile Homes Shipped (thousands)	241	232	233	241	241	245	246	249	249	233	240	249
HOME PRICES												
Existing Home Prices - Median ($1000)	85.5	84.4	86.8	87.3	90.2	92.5	93.4	94.0	80.3	84.9	89.2	93.6
Percent change -- year ago	5.9	5.2	3.0	2.6	5.5	9.6	7.6	7.7	6.4	5.7	5.1	4.9
New Home Prices - Median ($1000)	106.1	110.6	107.0	108.3	110.0	111.4	111.7	112.8	92.0	103.9	109.2	114.4
Percent change -- year ago	13.4	16.3	9.9	4.7	3.7	0.7	4.4	4.2	9.1	12.9	5.1	4.8
FINANCIAL MARKETS												
Long-Term Interest Rates												
30-year Fixed Rate Mortgage (FHA Secondary)	10.7	10.8	10.3	10.2	10.4	10.5	10.6	10.8	9.9	10.2	10.3	10.9
1-year ARM (without buydown)	8.3	8.2	8.0	8.0	8.2	8.2	8.3	8.5	7.9	8.2	8.1	8.5
Corporate AAA Bond Rate	9.8	10.2	9.8	9.6	9.7	9.8	9.9	10.1	9.0	9.4	9.7	10.2
Government Bond Rate	9.1	9.2	8.9	8.8	9.0	9.1	9.3	9.4	7.8	8.6	9.0	9.4
Short-Term Interest Rates												
Federal Funds Rate	6.8	6.9	6.7	6.7	6.8	7.0	7.2	7.3	6.8	6.7	6.8	7.4
3-month T-Bill Rate	6.0	5.9	5.8	5.8	6.0	6.2	6.3	6.4	6.0	5.8	6.0	6.4
Prime Rate	8.4	8.9	8.7	8.6	8.8	8.8	8.9	9.0	9.2	8.2	8.7	9.1
Discount Rate	5.7	6.0	5.9	5.8	5.8	6.0	6.2	6.4	6.3	5.7	5.9	6.0
Value of the U.S. Dollar (Trade-Weighted Avg.)	98.7	92.3	88.8	88.3	86.2	85.1	84.1	83.2	112.3	96.9	87.1	82.7
Percent change	7.2	-23.5	-14.2	-2.5	-9.1	-4.9	-4.4	-4.5	-21.6	-13.6	-10.2	-5.1

Source: Forecast produced using Laurence H. Meyer and Associates' model of the U.S. economy.
Assumptions and simulations by Dr. John Tuccillo, Dr. Frederick Flick and Sean Burns.

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REAL ESTATE

Vol. 1, No. 4

OUTLOOK

April 1988

A Monthly Forecast for the Economy and Real Estate

FORECAST SUMMARY

- The annual rate of real GNP growth in the fourth quarter of 1987 was revised upward to 4.8 percent from 4.5 percent. This second upward revision came amid favorable monthly reports of further increases in industrial production and employment. As a result, the forecast for the annual rate of first quarter real GNP growth has been revised upward from 0.8 percent to 2.2 percent.
- Consumer price inflation has been modest so far in 1988. The average annual rate of increase in the CPI settled down to 3.0 percent during January and February. Higher inflation rates are likely in 1988, because industries are producing at or near their capacity levels, and unit labor costs are expected to rise due to higher wage settlements.
- The surprising strength of first quarter economic growth has allowed the Fed to concentrate on controlling inflation rather than on reducing the chances of a recession. Consequently, the Fed has pursued a tighter approach to monetary policy which has caused yields to begin climbing on short-term instruments. The recent fluctuations in the dollar's value have complicated the Fed's task.
- Long-term interest rates have been rising in recent weeks as the bond market rally has shown signs of slowing. As a result, mortgage interest rates have begun to rise modestly. The current forecast expects the secondary market yield of thirty-year fixed rate mortgages to rise above 10.5 percent by mid-1988. Further increases are likely in the second half of 1988 as the rate of economic growth and inflation accelerates.
- Existing home sales are showing surprising strength so far in 1988. The February annual rate of existing single-family home sales reached 3.29 million units, a 3.8 percent rise above the January annual rate of 3.17 million units. However, the February 1988 annual rate of existing home sales was still 11.3 percent below the February 1987 annual rate of 3.71 million units. Existing single-family home sales are expected to reach 3.28 million units in 1988.

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- Economic Commentary: Feeding Frenzies and Other Fishy Behavior, by John A. Tuccillo
- Outlook for the Economy and Real Estate, by Sean A. Burns
- Special Supplement: The President's FY1989 Budget, Overview of Various Categories of Spending, by Frederick E. Flick

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FEEDING FRENZIES AND OTHER "FISHY" BEHAVIOR:

Economic Commentary

by
John A. Tuccillo
Chief Economist and
Senior Vice President
Real Estate Finance

Lemmings have gotten a bad rap. Fish are the real mindless creatures of nature. Most of us are familiar with the somewhat peculiar -- at least to humans -- behavior of fish travelling in schools. Seemingly without reason, hundreds of the fish will suddenly turn in unison and head in the opposite direction; seconds later, they will reverse course. Such behavior has its human counterpart in financial markets. Traders, caught up in a frenzy of mob momentum, will follow the prevailing trend with no thought to its logic or its effect on their own self-interest.

In the past, these panics have occurred infrequently -- prior to 1929, the last financial crash had occurred in 1907. Now, we see significant changes in stock prices and volume, in interest rates and currency values on a weekly basis. Why? Essentially there are five reasons:

1. Large Block Trading. Stock and bond price indexes are weighted averages of daily trades. As institutional investors (mutual funds, pension funds) have come to dominate the market, the weights have grown larger, because the average transaction is larger. This means that even small price movements tend to loom large in the indexes.

2. Technology. Computerization has given even more weight to the activities of large traders. Most big players now use computers to signal the proper time to buy and sell. The problem is that all the programs give off the same signals. When the market moves, technology will give it a further momentum. So, small swings become large.

3. Financial Journalism. With the proliferation of financial TV shows and newspapers, there has been increasing competition for stories. So, just as TV news has made stars of tin-horn felons and obscure rebellions, TV financial news has made stars out of statistics and even (ugh!) economists. Should market traders care about the monthly trade numbers? No (monthly numbers are unreliable and the true picture is shown only annually). Do they care? Probably a lot. Why? Because the financial media tell them to. The result is a jittery market that hangs on the arithmetic of obscure bureaucrats.

4. Uncertainty About the Economy. There is no clear consensus yet that the economy will continue to expand in 1988 -- at least among market participants. The crash of October 1987 so shattered confidence (remember, most of the wheeler-dealers are young enough never to have seen a bear market) that most players don't know what to believe. Hence, they soar on a "good" number and crash on a "bad" one. And it doesn't help that the media produces reams of instant analysis.

5. Internationalization. Financial markets now trade around the clock. What happens in Tokyo and London affects the U.S. long before the westward sweep of the sun has reached the shores of Maine. As the players increase in number, and as world markets enter the game, the risk of strong movement increases. Just ask the former management at Continental Illinois Bank.

Believe it or not, all this has a direct bearing on real estate. The classic good and bad news is that all financial markets are tied together: good news because the pool of funding for real estate is larger; bad news because in this skittish age price fluctuations will be more severe. That means that in 1988, we will see at least one interest rate spike of the magnitude and duration of that which occurred a year ago. In late March 1987, the announced trade deficit number for February was unexpectedly large, traders panicked and interest rates shot up. The markets are just as jittery now as they were then, and there will be some piece of news trumpeted through the media that will trigger a jump in rates and shut down our markets.

Unfortunately, the timing of rate spikes cannot be predicted. But, the economy in 1988, although weaker than last year, is growing in an atmosphere of steady rates and low inflation. So, when rates run up, hold tight and ride out the four to six week frenzy. Eventually, the fish will turn again.

Outlook for the Economy and Real Estate

THE ECONOMIC OUTLOOK

The annual rate of real GNP growth in the fourth quarter of 1987 was revised upward to 4.8 percent from 4.5 percent. The initial report of 4.2 percent real GNP growth was due almost entirely to inventory building, suggesting a production slowdown might take place in the first quarter of 1988. However, the two subsequent upward revisions and positive news from recent monthly indicators on employment and industrial production imply a stronger first quarter than previously expected. As a result, we have revised upward our estimate of the annual rate of real GNP growth in the first quarter, from 0.8 percent to 2.2 percent. While the new estimate is significantly higher, real GNP growth during the first half of 1988 is still not expected to approach the 4.5 percent average annual rate of the second half of 1987. Instead, weaker home sales and housing starts, relative to 1987, and rising interest rates in the second half of 1988, will likely hold real GNP growth to an annual rate of 2.9 percent in 1988.

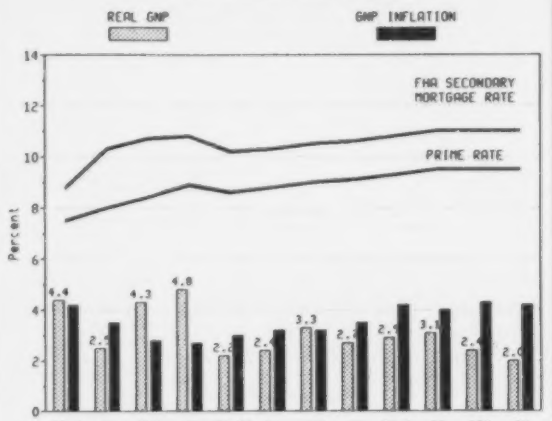
Industrial Production Still Rising

The index of industrial production continued to advance in January and February, but at a slower rate than in recent months. The index of industrial production rose 0.3 percent in January and 0.2 percent in February. Apparently, businesses are reacting to high levels of inventories by trimming production. However, gains in the index in the past year have been substantial. Gains in manufacturing production due to higher demand for U.S. exports have helped drive up the overall index. In just the past 12 months alone, manufacturing output has risen by about 6%. The manufacturing capacity utilization rate, which had also been rising almost steadily since last spring has stabilized at 82.4 percent since December. Part of this pause could be in response to high inventory levels. At present, operating rates are fast approaching the high rates of the late 1970's when many industries reached peak capacity. In fact, some industries (such as primary metals, paper, textiles, and chemicals) are already operating at or above their peak levels. Without increases in capacity to meet demand for exports, U.S. producers may begin to ration products through price increases.

Employment Gains, Unemployment Falls

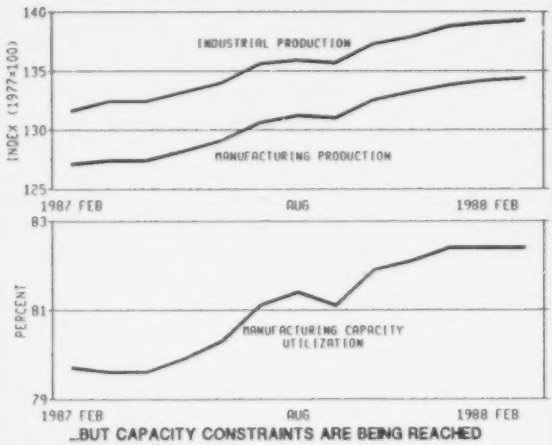
Nonagricultural payroll employment surged ahead by 531,000 jobs in February, after rising by 174,000 jobs in January. This 350,000 average monthly job gain is about the same rate of employment growth experienced in the fourth quarter of 1987, but it is a faster rate than the 250,000 average monthly job increase in the past year. Employment gains were concentrated in the service-producing industries. However, the longer term trend (shown in the graph) is steady job growth in goods-producing industries. Recent data supports this trend. In the first half of 1987, the average monthly job gain in goods-producing industries was only 22,000 jobs, compared to an average monthly gain of 83,000 through the second six months. In the fourth quarter, job gains in goods-producing industries averaged 114,000 per month. Continued employment growth cut the unemployment rate to 5.7 percent in February, almost one full percentage point below the February 1987 rate.

GRAPH 1: THE ECONOMIC OUTLOOK



E NAR estimates (1988:I THRU 1989:IV).

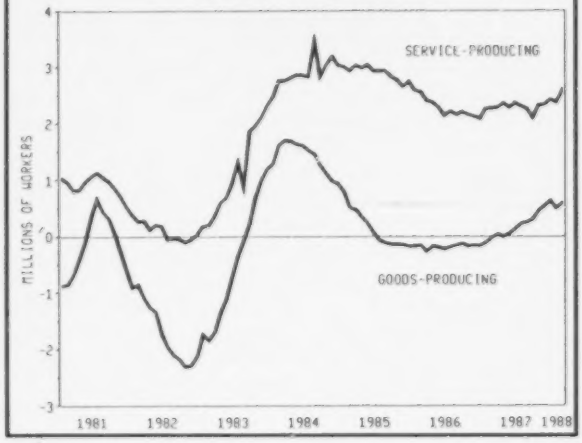
GRAPH 2: INDUSTRIAL PRODUCTION KEEPS ADVANCING...



...BUT CAPACITY CONSTRAINTS ARE BEING REACHED

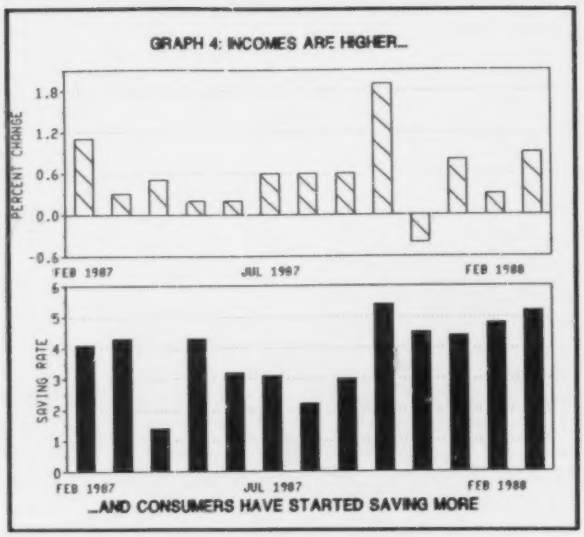
SOURCE: FEDERAL RESERVE

GRAPH 3: EMPLOYMENT GROWTH IN GOODS-PRODUCING INDUSTRIES ON THE RISE
(YEAR-OVER-YEAR CHANGE)



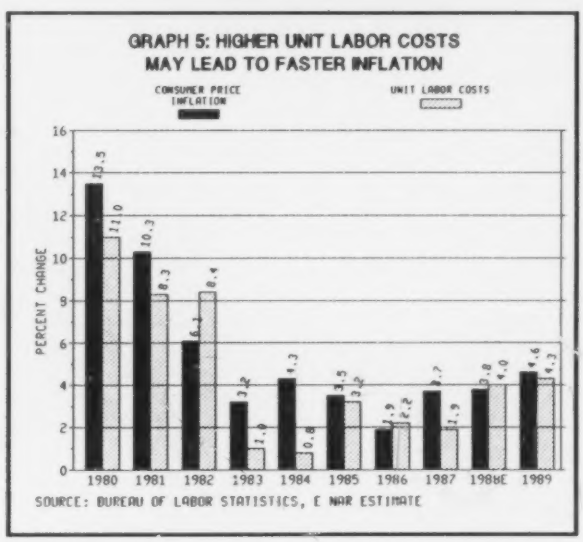
Higher Personal Incomes Boost Savings

Personal Income rose 0.9 percent in February after increasing 0.3 percent in January. Personal income growth was actually more stable over the two month period if the combined effects of farm subsidies, cost of living increases and increased social security taxes are excluded. In that case, personal income rose 0.5 percent in January and 0.7 percent in February. In comparison, the average monthly gain in personal income during 1987 was 0.6 percent. Consumers have not been spending all of the increases, but instead are choosing to save an increasing share. This does not signal a retrenchment in consumer spending; consumer spending is expected to contribute positively to GNP growth throughout 1988. Rather, it seems to indicate consumers have put a higher premium on saving for the future in light of last October's stock market crash. The savings rate rose to 5.2 percent in February, from 4.8 percent in January, and an annual average of 3.8 percent during 1987.



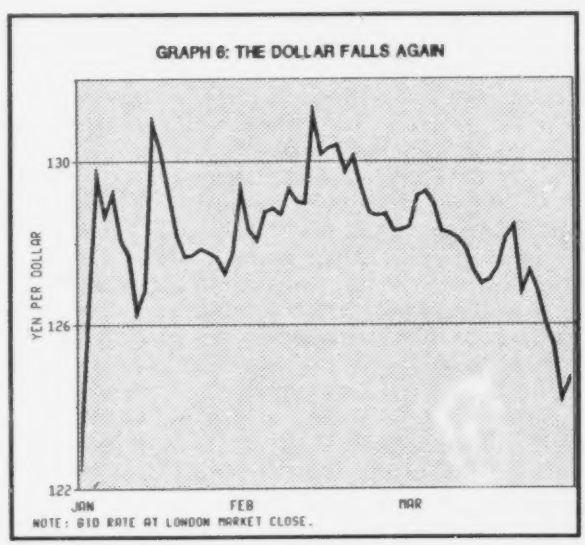
Faster Inflation in the Second Half of 1988

The economic fundamentals of steady but slow GNP growth coupled with stable or declining oil prices bodes well for the inflation outlook in 1988. For the year, consumer prices are expected to rise by 3.8 percent in 1988, only slightly faster than the 1987 advance of 3.7 percent (year-over-year basis). During January and February of 1988, consumer prices rose at an average annual rate of about 3.0 percent. However, while the first six months of 1987 witnessed the fastest rates of inflation for the year (due mainly to sharply rising oil prices), the second six months of 1988 will likely experience the year's highest inflation rates. An important factor affecting the inflation outlook is unit labor costs, which have risen very slowly during much of the 1980's. Wage settlements for new contracts will likely be higher in 1988 and 1989, especially in light of the tight labor market conditions implied by the 5.7 percent unemployment rate. In addition, faster economic growth, further steady declines in the dollar, another climb in oil prices, and high capacity utilization rates will all likely contribute to a trend of moderately accelerating inflation which could carry into 1989.



More Uncertainty About the Dollar

For international investors holding dollar assets, March came in like a lamb and went out like a lion. Late in March a run on the dollar developed, ending a period of relative stability in the dollar's value dating back to December when the world's central banks supported the dollar at about 126 yen. Some traders think that the dollar is not so much overvalued as the *yen is undervalued*. The Japanese economy is enjoying broad economic growth which is attracting funds from investors presently holding dollars. Further, reports on first quarter U.S. economic growth were stronger than expected causing some investors to fear that the American consumer will continue to buy imported goods, slowing improvement in the trade gap. Another reason for the dollar slide may be that Japanese companies holding dollar assets are adjusting their portfolios to prepare for new regulations governing how to report exchange rate losses that went into effect on March 31, the end of the Japanese fiscal year.



Monetary Policy and Interest Rates

Yields on both short- and long-term instruments have softened since the beginning of the year. The 3-month Treasury bill yield slipped below 5.7% in early February (weekly average) and has remained at about that level through March. The Fed, confident the economy is not about to fall into a recession, has apparently decided not to encourage rates to fall any further. Instead, the Fed appears to be more concerned with keeping the inflation rate moderate. The 30-year government bond yield fell to a rate of 8.39% (weekly average) in the first week of February, and then fluctuated between 8.4% and 8.5% through the remainder of the month. By the second week of March, investors had heard enough evidence on the strength of first quarter economic growth to make them nervous about the prospects for higher rates of inflation in coming months. This nervousness was largely responsible for pushing the long-term government bond rate above 8.75% in the last part of March, before it settled back below 8.7%.

Long-term interest rates are not expected to test the lows of early 1987, when the 30-year government bond yield fell to a low of 7.3 percent in the first month of that year. Instead, there are significant upside risks to the long-term interest rate forecast. The current forecast does not assume this is the most likely scenario, instead projecting a steady rise in long-term interest rates during 1988 as economic growth strengthens in the second half of the year, paralleled by a steady decline in the value of the dollar. A resurgence of inflation beyond what is currently forecast could produce an interest rate spike later this spring or early summer. The spark for such a rapid price advance could come from increases in unit labor costs, a very important component of the inflation rate calculations done monthly by the government. Also, concerns about faster rates of inflation are already being factored into long-term yields in the credit markets. This raises the likelihood of a trend of rising long-term interest rates in 1988.

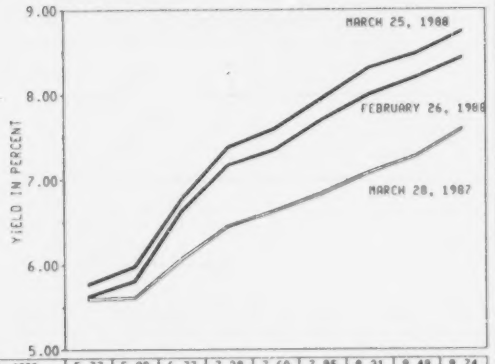
REAL ESTATE MARKETS

Housing Starts

Apparently shaking off the effects of extreme winter weather and the anomalies of seasonal adjustment factors, housing units were started at an annual rate of 1.494 million units in February, 9% above the January annual rate of 1.372 million units. The February annual rate was 17 percent below the February 1987 annual rate of 1.838 million units. Total housing starts rose in the Northeast (+2.7%), the Midwest (13.8%) and the South (25.6%), but fell in the West (-9.0%). Single-family housing starts in February were reported at an annual rate of 1.095 million units, a 9% increase above the January annual rate of 1.002 million units. Multi-family units were started at an annual rate of 399 thousand units in February, 7.8 percent above the January annual rate of 370 thousand units. Total housing starts are expected to reach 1.51 million units in 1988, down 7.8 percent from the 1987 total of 1.63 million units. Single-family starts could reach 1.08 million units in 1988, 6.2 percent below their 1987 level of 1.16 million units. Multi-family starts could reach 422 thousand

GRAPH 7: THE YIELD CURVE STEEPENS

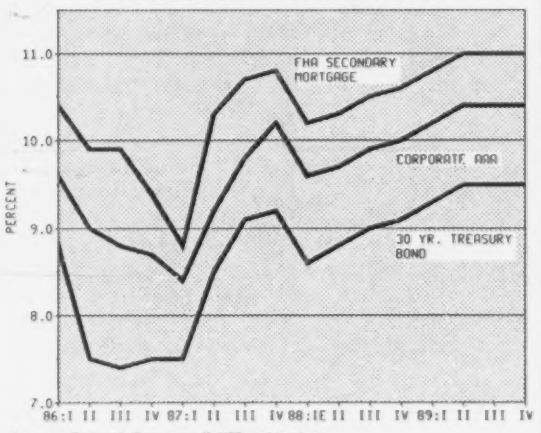
(RATES ARE FOR U.S. TREASURY CONSTANT MATURITY ISSUES)



	3 MO.	6 MO.	1 YEAR	2 YEAR	3 YEAR	5 YEAR	7 YEAR	10 YEAR	30 YEAR
MARCH 25, 1988	5.77	5.98	6.77	7.38	7.60	7.95	8.31	8.48	8.74
FEBRUARY 26, 1988	5.63	5.81	6.63	7.17	7.35	7.70	8.00	8.20	8.43
MARCH 28, 1987	5.60	5.61	6.07	6.45	6.63	6.83	7.08	7.27	7.59

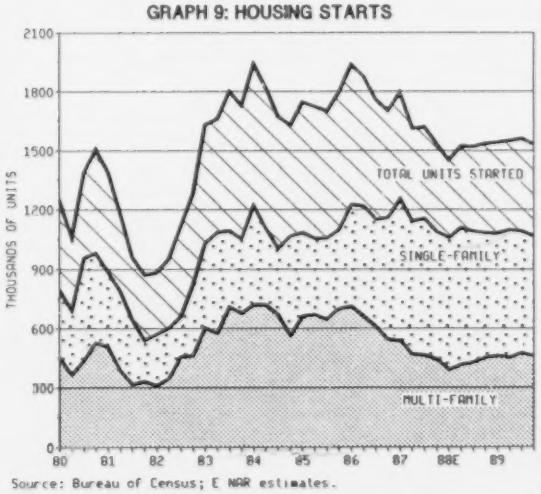
SOURCE: FEDERAL RESERVE BOARD.

GRAPH 8: LONG-TERM INTEREST RATES



Source: Federal Reserve; E NAR estimates

GRAPH 9: HOUSING STARTS



Source: Bureau of Census; E NAR estimates.

units in 1988, down 11.5 percent from the 1987 level of 477 thousand units.

While the numbers for housing starts indicate a slowdown, it is worth noting how long and how robust this current housing starts cycle has been. The graph shows that the present housing starts cycle measures up very favorably against other recent housing cycles. In particular, the current housing cycle has reached higher levels of activity than any other, and it has maintained those higher levels longer than any other cycle. Further, it is not clear that the present cycle is near to being over. The recent negative data on starts activity in the winter months must be discounted, leaving analysts to focus on the economic fundamentals. For the short-term, the fundamentals of stable or slowly rising mortgage interest rates, the availability of adjustable rate mortgages and personal income growth imply some further growth in housing starts.

New Home Sales

New single-family homes were sold at an annual rate of 628,000 units in February, a 20 percent advance over the January annual rate of 522,000 units. However, the February 1988 gain left the annual rate of new single-family home sales 15 percent below the February 1987 annual rate of 738,000 units. Unusually bad winter weather may have been partly responsible for the wide swing in new home sales rates in the Northeast: the January-November seasonally adjusted average annual rate was 120,000 units, compared to rates of 76,000 and 82,000 in December and January, respectively. In the short-term, new home sales are expected to rise modestly, reaching a total of 646,000 units in 1988. The median new home price declined 6.1 percent in February, falling to $110,800 from the January level of $118,000. New home price appreciation will more than keep pace with inflation in 1988, after rising 12.9 percent in 1987.

Existing Home Sales

Existing single-family homes were sold at an annual rate of 3.29 million units in February, up 3.8 percent from the January annual rate of 3.17 million units. The February advance ended a three month decline, but the home sales rate remained 11.3 percent below the 3.71 million unit annual rate of February 1987. The annual rate of home sales declined by 5.4 percent in the Midwest (870,000 units), and by 1.9 percent in the West (520,000 units), but rose 8.2 percent in the Northeast (660,000 units) and 12.8 percent in the South(1.23 million units). The large decline in the Midwest is expected to be reversed by an export-led growth surge in 1988. Across the nation, existing home sales may be boosted by expectations of rising interest rates. Also, higher consumer incomes due to the export boom could contribute to higher home sales rates. Existing single-family homes should be sold at an increasingly faster annual rate during 1988, reaching a total of 3.28 million units. The median sales price of an existing single-family home rose 6.6 percent in 1987 to $85,600, and could rise 5.3 percent in 1988 to $90,100.

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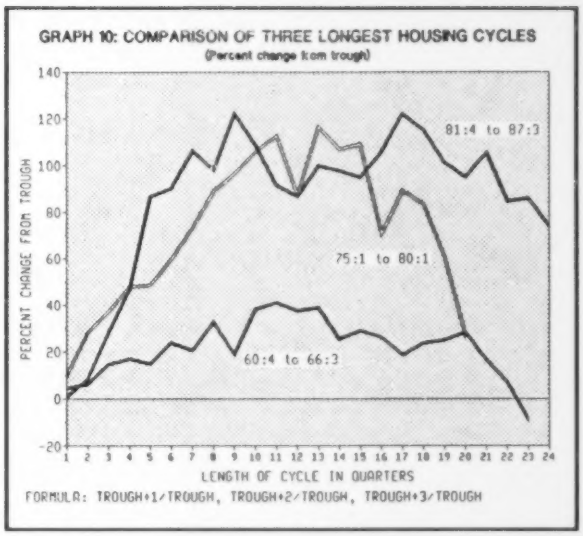
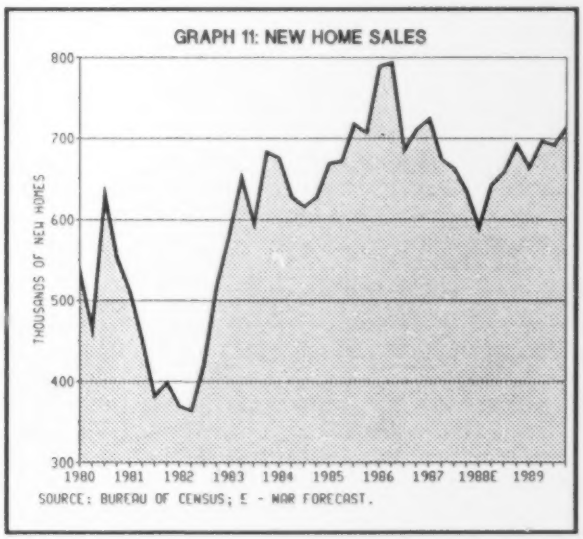
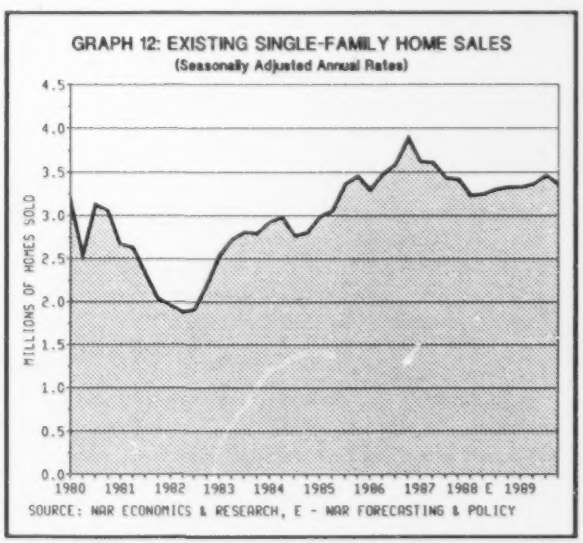

GRAPH 10: COMPARISON OF THREE LONGEST HOUSING CYCLES
(Percent change from trough)
PERCENT CHANGE FROM TROUGH
81:4 to 87:3
75:1 to 80:1
60:4 to 66:3
LENGTH OF CYCLE IN QUARTERS
FORMULA: TROUGH+1/TROUGH, TROUGH+2/TROUGH, TROUGH+3/TROUGH




GRAPH 12: EXISTING SINGLE-FAMILY HOME SALES
(Seasonally Adjusted Annual Rates)
MILLIONS OF HOMES SOLD
SOURCE: NAR ECONOMICS & RESEARCH, E - NAR FORECASTING & POLICY

SPECIAL SUPPLEMENT:

THE PRESIDENT'S FY 1989 BUDGET,

OVERVIEW OF VARIOUS CATEGORIES OF SPENDING

by
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Forecasting & Policy Analysis

In mid-February, President Reagan submitted what will be his last fiscal year budget to Congress. The bottom-line total was $1.09 trillion with an estimated deficit of $129.5 that included economic assumptions ensuring compliance with the maximum deficit of $136 billion set by the Gramm-Rudman-Hollings (GRH) law. Also, because the total amount for this year had been set in the budget accord reached in November, that is another point in its favor. However, the deficit number relies on $13 million in asset sales which, according to the deficit accord, cannot count toward fulfilling the GRH target. Nevertheless, the Administration figures Congress will not fight on that point. Otherwise, there seem to be no surprises.

The Proposed FY 1989 Budget

Of the total $1.09 trillion budget, expenditures in the Social Security and Medicare function (mostly non-discretionary) comprise the largest share at $317.8. The Department of Health and Human Services budget totals $396.8 (most of which is Social Security). The second largest budget is for Defense for an outlay total of $285.5 billion, the fourth consecutive year of decline in inflation-adjusted spending. It does not achieve the 600-ship Navy and the Air Force is cutting back on the number of tactical fighter wings it desired. Furthermore, the number of uniformed personnel will be cut by 36,000 from the current 2,174,000 and a number of weapons systems will be cut. It does include a 4.3 percent increase in military pay.

The next largest component of the budget is the interest on the national debt (net of interest earned by U.S. Government accounts) estimated to total $151.8 billion in FY 1989. Outlays for Federal pensions, unemployment and other income security are expected to total $135.6 billion. These outlays are generally non-discretionary, depending on prior commitments and the state of the economy. It is important to note that Social Security/Medicare, Federal pension/income security, and Net Interest outlays total over $600 billion - more than 60 percent of the proposed budget. Finally, Defense accounts for almost 30 percent of the budget. The remaining 11 percent is spread among discretionary spending programs in nine cabinet agencies.

New Tax Breaks**

The budget also contains several non-controversial revenue losing tax breaks, mostly supported by Congress:

- A permanent research and development tax credit ($600 million revenue loss in FY 1989 and $2 billion over three years).
- Repeal of the windfall profit tax -- due to low oil prices the repeal is revenue neutral.
- Increases in the oil and gas depletion deduction for transferred properties to 100 percent (less than $100 million revenue loss in 1989).
- A branch profits tax credit for U.S. shareholders in foreign companies owning U.S. branches (less than $50 million loss in FY 1989 and $200 million over three years).
- The "67 percent" solution to Sec. 861 research expense allocation ($400 million FY 1989 revenue loss and $2.2 billion over 3 years).
- Permanent exemption of mutual fund shareholders from the two percent floor on miscellaneous itemized deductions ($400 million loss in FY 1989 and $1.5 billion over three years).
- Exempt the interest on savings bonds redeemed to pay post-secondary educational expenses (less than $50 million loss in FY 1988).

New Taxes Proposed**

To pay for these new losers, the Administration proposes to extend Medicare taxes to state and local employees, which was rejected by Congress last year. If it were adopted, it is expected it would raise $1.6 billion in 1989 and $5.7 billion over three years. Also, increases in user fees charged by the Nuclear Regulatory Commission and Federal Emergency Management Agency to raise $600 million were proposed, as well. Finally, the proposal recommends repeal of a scheduled 50 percent reduction in airway and airport trust fund taxes, saving $1.2 billion in the trust fund. The sum of the new taxes is estimated to net $700 million in FY 1989.

**Source: "President Submits Budget to Congress," and "Administration's Fiscal 1989 Budget Contains No Surprises," Tax Notes, pp. 757-759, February 22, 1988.

The Structure of the Budget

The President's budget provides the Budget Message of the President; an analysis of trends in budget policy and national priorities, a detailed statement of the priorities for the proposed expenditures; discussion of economic assumptions used in deriving the revenue and expenditure figures; a number of Special Analysis relating to issues that merit in-depth treatment; a listing of the proposed Federal program funding authority and

projected outlays, and a plethora of historical data on program authority and expenditures.

The budget includes authority requests and expenditures for the Legislative and Judicial branches as well as the Executive branch (i.e., Executive Offices of the President, Cabinet Departments, and federal agencies and corporations). The figures include staff costs, management expenses, direct program expenditures, trust fund receipts, and accounting/economic concepts that are applied in measuring program outlays. The budget encompasses four printed volumes weighing approximately 10 lbs. In short, it's a veritable paradise for number drones and management accounting-types. The only qualification is that Congress takes these figures and then spends almost one year in deliberating to come up with a different set of figures. Thus, we really do not know what the "true" budget will be for a year. Furthermore, after that is done, the Administration can find some ways to avoid carrying-out some of the budget priorities through its day-to-day management of the programs.

However, since the President's budget represents a jumping-off point for the process, it is useful to examine these proposals. Furthermore, the budget is ultimately a policy tool for affecting the overall economy and the allocation of resources among various social and economic priorities.

Federal Programs by Function

The primary mode of presentation of the budget is by a functional classification which focuses on the nature of the national needs or end purposes served by the spending. In that way it is similar to the NAR budget process which looks toward the objectives of the Association's Strategic Plan. This structure includes 19 functions plus two additional categories - allowances and undistributed offsetting receipts. Each function is further divided into subfunctions, consisting of more homogenous groupings of programs.

In each functional area, the budget encompasses requested funds to be authorized or appropriated in various years, as well as funds that are projected as outlays or direct expenditures in those periods. Thus, the budget is a multi-year document involving proposed and existing authority to spend as well as proposed and anticipated expenditures. The figures also include proposed cancellations ("rescissions") of spending authority or outlays (that have not been made) and new spending through newly proposed legislation.

Relationship of Budget Authority to Outlays

The Congress must usually provide budget authority, which is generally in the form of appropriations, before Federal agencies can obligate the government to make outlays. For 1989, $1,233.2 billion of new budget authority is proposed for the Federal government. Of this amount, $974.7 billion is for agencies included in the budget and $258.5 billion is for off-budget Federal entities.

Of this total new budget authority, both on-budget and off-budget, $601.9 billion will require congressional action. New budget authority of $849.2 billion will be available through permanent appropriations under existing law. This consists mainly of trust fund receipts, which in most programs are automatically appropriated under existing law, and interest on the public debt, for which budget authority is automatically provided under permanent appropriation legislation enacted in 1847. This gross amount of new budget authority is partially offset by $218.0 billion of deductions for offsetting receipts, which consist of proprietary receipts from the public and collections of one government account from another.

Because not all of any new authority will be necessarily spent in a year (i.e., due to multi-year financing, slower than anticipated program disbursements or start-up, and long-term contract commitments) a substantial amount of budget authority carries over from one year to the next. For example, in the housing area, budget authority for large portions of the subsidized housing programs is equal to the government's estimated obligation to pay subsidies under contracts, which may extend for periods up to 20 years.

In FY 1989, $348.8 billion of the outlays (32 percent of the total) will be made from budget authority enacted in previous years. At the same time, $487.7 billion of the new budget authority proposed for 1989 (40 percent of the total amount proposed) will not lead to outlays until future years. Thus, the total budget authority for a particular year is not useful for the analysis of that year's outlays, since it combines various types of budget authority that have different short-term and long-term implications for budget obligations and outlays.

Consequently, our analysis below will concentrate on budget outlay proposals and estimates of future outlays. The discussion mentions authority when it directly affects proposed outlays.

On-Budget Versus Off-Budget Activities

The budget does not include some activities of the Federal government that result in spending similar to budget outlays. These activities, nevertheless, channel economic resources and have effects that are similar to budget spending. The total receipts and outlays of the Federal government are composed of both on-budget receipts and outlays of the off-budget receipts and outlays. These receipts and outlays of the off-budget Federal entities are a significant exclusion from the budget.

Since 1971, various laws have been enacted where several Federal entities were removed from the budget or created outside the budget. Other laws moved certain off-budget Federal entities onto the budget. Under current law, the off-budget Federal entities consist of the two social security trust funds, old-age and survivors insurance and disability insurance.

The Off-budget Federal entities are federally owned and controlled, but their transactions are excluded from the budget totals under law. When an entity is off-budget, its receipts, outlays, and surplus or deficit are not included in budget receipts, budget outlays, or the budget deficit; its budget authority is not included in the totals of budget authority for the budget; and its receipts, outlays, and surplus or deficit ordinarily are not subject to the targets set by the congressional budget resolution.

Nevertheless, the Balanced Budget and Emergency Deficit Control Act of 1985 (The Gramm-Rudman-Holl-

ings Act) included the off-budget surplus or deficit in calculating the deficit targets under that Act and in calculating the excess deficit for purposes of that Act.

The Federal entities that were off-budget until 1986 primarily made direct loans to the public. The Gramm-Rudman-Hollings Act, however, placed on-budget all of the entities that were then off-budget. This Act also changed the budgetary status of social security. The Social Security Amendments of 1983 had already required that beginning in 1993 the old-age and survivors insurance trust fund (OASI), the disability insurance trust fund (DI), and the hospital insurance trust fund (HI) would be excluded from the budget. The GRH act required that OASI and DI be off-budget as of 1986, even though, it provided that their receipts and disbursements should be included in calculating the deficit targets. In order to provide consistent comparisons over time, the on-budget and off-budget amounts for previous years that are published in the budget documents are calculated on the basis of the current definition of off-budget entities. The transactions of HI are shown as on-budget amounts.

In 1989, the off-budget receipts are an estimated 27 percent of total receipts, and the off-budget outlays are an estimated 19 percent of total outlays. The off-budget surplus of $45.1 billion is significant. Off-Budget receipts and outlays have grown more rapidly than the on-budget amounts since 1970 and are estimated to continue growing more rapidly through 1993. The off-budget entities in total had deficits during 1976-82, but because of the Social Security increase of 1983 and an expanding economy they have had surpluses beginning in 1983 and are estimated to have growing surpluses through 1993.

The Federal Credit Budget

One area of increasing concern to the government has been the expansion of the use of Federal credit guarantees. The Federal government is the largest financial intermediary in the United States. At the end of 1987, it held outstanding loans with a face value of $234 billion in its direct loan portfolio and had another $507 billion in guaranteed loans outstanding. Government-sponsored enterprises had an additional $581 billion of loans outstanding at the end of the year. Thus, directly or indirectly, the government had influenced the allocation of $1.3 trillion of outstanding credit.

Housing guarantees dominated Federal guarantee activities during the 1950s and 1960s, and despite increases in other loan guarantee programs during the 1970s and early 1980, continue to represent a majority of all new loan guarantees. The housing programs of the FHA and Veterans Administration accounted for 84 percent of the total volume of new commitments for guaranteed loans in 1962. However, the range of activities financed with Federal guarantees has widened since that time. For the 1989 budget, housing programs account for an estimated 69 percent of all new loan guarantee commitments.

To control the growth of these guarantees, the government has created the Federal Credit Budget. This measurement tool has been used since January 1980. However, this concept represents a radical departure from traditional government accounting practices by including amounts that are not direct government costs. The Government Accounting Office (GAO) has strongly recommended against including any amounts in appropriations or outlays that are not direct costs to the government.

The Federal credit budget attempts to measure and control the volume of new direct loans and loan guarantees extended to borrowers. It is intended to measure new credit at the point at which the government legally contracts to provide a loan or loan guarantee. The credit budget is based on credit authority, is measured on a gross basis and does not reflect repayments of loans or defaults on loan guarantees. Guaranteed loan commitments are measured as the full principal of the loan, even if the government's contingent liability is less than the full loan principal. The full loan principal is included in the commitment because the entire loan, even if only partially guaranteed, is assisted by the guarantee.

The credit budget is included in the budget resolution, and limitations for many programs are enacted in annual appropriations acts. The Administration proposes limitations annually on direct loan obligations and guaranteed loan commitments for many credit programs. The limitations serve as ceilings on the volume of new credit that may be offered by the account in a given year. The limitation is specified in the appropriations language for individual budget accounts that include credit activity.

The Administration is proposing limitations in 1989 for programs amounting to 74 percent of the credit budget totals. Approximately 38 percent of direct loan obligations and 80 percent of guaranteed loans are included under the proposed limitations.

Changes in Federal Credit Measurement

As part of the Administration's efforts to control and cap Federal credit involvement, it proposed legislation in March 1987 to change the budgetary treatment of outlays involving credit. Last spring, this legislation was passed, in modified form, by the Senate but not by the House. The Congressional Budget Office was directed, in consultation with the General Accounting Office, to report as soon as possible on measuring the cost of credit programs more accurately, and comparing them with other programs. Thus, in the various subfunction outlay estimates, the line item "proposed credit reform" appears. These figures represent estimates of alleged subsidy costs using financial analysis techniques. It is important to realize that these are Administration estimates and that this controversial methodology has not yet been accepted by Congress.